



Economic Update

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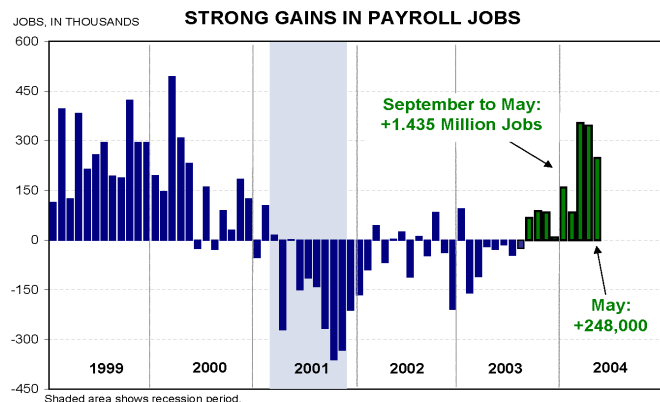
Expansion Broadens Across Major Sectors MANY GROWTH MEASURES AT 20-YEAR HIGHS

Widespread evidence of growth across major sectors of the economy – including the robust jobs gains of recent months – confirms Federal Reserve Chairman Greenspan’s recent observation that “the economy is growing in a solid fashion.” Strong jobs gains for all major industry groups, and falling unemployment, reveal employers’ increased confidence in the economy’s prospects. At the same time, various measures of real growth and activity have reached their strongest paces in 20 years, and benefits of the expansion are spreading throughout the sectors and industries of the economy. The continued optimism of consumers and businesses is supporting strong growth in consumption and investment spending as well. Absent any catastrophic events or major policy reversals, the factors contributing to expansion likely will continue supporting one another for the foreseeable future.

Private forecasters expect the strong growth to continue this year and through the end of next year. Conditions also point to likely, though modest, increases in short-term interest rates – a normal companion of such economic growth – but to levels that still remain low in historical perspective.

Recent Data

- *Gross Domestic Product [GDP]*: Real GDP growth in the first quarter was revised up to a 4.4-percent annual rate from the initial estimate of 4.2 percent. Real GDP growth over the past three quarters has averaged 5.6 percent at an annual rate – the strongest growth in 20 years.
- *Labor markets*: Following the initial sluggish performance of labor markets early in the expansion, unemployment and payroll jobs have shown significant improvement over the past year.
 - Nonfarm payroll employment rose by 248,000 jobs in May, following upwardly revised gains of 346,000 in April and 353,000 in March. Over the



past 9 months, payroll employment has increased by more than 1.4 million jobs (see chart).

- Manufacturing employment rose by 32,000 jobs in May, bringing the increase over the past 4 months to 91,000 jobs – the strongest manufacturing jobs gains in 6 years. The manufacturing average work week rose to 41.1 hours – the highest in 4 years.
- Payroll jobs gains were widespread in May, with all major private sector industries showing increases in jobs. The only major sector showing a decline in payroll jobs was government (-27,000), almost all from reductions in Federal employment.
- The unemployment rate has been trending down over the past year, to 5.6 percent in May from 6.3 percent in June 2003. At 5.6 percent, the unemployment rate is lower than the decade averages for the 1970s, 1980s, and 1990s.
- The Manpower Employment Outlook Survey shows that strong employment gains are likely to continue: the employment outlook in the second and third quarters is the strongest since the beginning of 2001, before the recession.

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- *Other major indicators* confirm the positive outlook, and continue to show that robust growth is widespread.

- Manufacturing activity indexes continue near 20-year highs, and industrial production is up 6.3 percent over the past year. Industrial production rose 1.1 percent in May – the largest monthly gain in more than 6 years – and has now recovered to exceed its prerecession peak in June 2000.

- New orders for durable goods have increased 14 percent in the past year.

- Housing sales and real residential investment are at record high levels, and housing starts are near 20-year highs.

- Crude oil prices have fallen below \$40 per barrel, and the national average price of gasoline fell to \$1.99 per gallon in the week ending June 14, down from \$2.06 per gallon 3 weeks prior.

- Despite recent increases in Consumer Price Index [CPI] inflation (up 3.1 percent over the past year), core inflation – excluding food and energy items – continues at relatively low levels: it is up 1.7 percent over the past year.

- Consumer sentiment jumped in June – to 95.2 from 90.2 in May – and sentiment continues at levels consistent with the economy in a sustained expansion. The June value is significantly higher than the post-recession low of 77.6 in March 2003.

- Real disposable personal income (income adjusted for taxes and inflation) and real personal consumption spending are up about 4½ percent over the past year – reflecting the strong economic growth and the 2003 tax relief. Retail sales rose an impressive 1.2 percent in May.

Economic Outlook

Private forecasters expect that the U.S. economy will continue to grow strongly for the remainder of this year and that above-average growth will occur next year. Real GDP growth is expected to average about 4¼ percent during 2004

and about 3½ percent during 2005 (see table with Blue Chip forecast numbers). The unemployment rate is expected to continue downward, falling to 5.4 percent by the fourth quarter of this year and 5.2 percent by the end of next year. Recent increases in inflation are expected to subside, and inflation is expected to run at about 2¼ percent through the end of next year. Interest rates are expected to rise gradually over the next year and a half, with the 3-month Treasury bill rising from about 1.0 percent early this year to just above 3 percent by the end of next year, and the 10-year Treasury note yield rising from 4.0 percent to 5.5 percent.

Blue Chip Economic Outlook, June 2004									
	2003.4	2004.1	2004.2	2004.3	2004.4	2005.1	2005.2	2005.3	2005.4
	--- Actual ---					Projection			
Real GDP Growth	4.1	4.4	4.3	4.1	3.9	3.6	3.6	3.6	3.4
Unemployment Rate	5.9	5.6	5.6	5.5	5.4	5.4	5.3	5.3	5.2
CPI Inflation	0.7	3.5	3.2	2.2	2.1	2.2	2.2	2.2	2.3
3-month Treasury Bill	0.9	0.9	1.1	1.4	1.7	2.1	2.5	2.9	3.2
10-year Treasury Note	4.3	4.0	4.6	4.8	5.0	5.1	5.3	5.5	5.5

Monetary Policy

The Federal Reserve's Federal Open Market Committee is scheduled to meet in the last week of June and decide on the course of monetary policy. Fed Chairman Greenspan – who has been nominated and confirmed to a fifth term as Chairman – stated recently that “our best judgment is that the economy is growing in a solid fashion.”

In a recent speech, Chairman Greenspan offered one of his most transparent statements about monetary policy:

“Federal funds futures prices already reflect expectations of a substantial firming of policy by the Federal Open Market Committee [FOMC]. . . . The Committee is of the view, as you know, that monetary policy accommodation can be removed at a pace that is likely to be measured. . . . [H]owever, the FOMC is prepared to do what is required to fulfill our obligations to achieve the maintenance of price stability so as to ensure maximum sustainable economic growth.”

These statements are in line with the expectations of the Blue Chip private forecasters that the economy is growing strongly, and that interest rates will rise gradually in response to the stronger economy.

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